A HOLISTICALLY INTEGRATED PACKAGE

Submitted by Commissioner Robert Nelson to
Federal-State Joint Board on Universal Service

The package proposed herein responds to the issues in the Commission's referral to the Joint Board (CC Docket No. 96-45). It contains elements of the various packages previously submitted by Board members (Billy Jack Gregg and Commissioner Baum) as well as elements from the Universal Service Endpoint Reform Plan (USERP) submitted by Staff members Bluhm, Shifman and Parsley. In addition, it relies heavily on the Intercarrier Compensation proposal submitted as part of the record by the NARUC Task Force chaired by Commissioner Elliott Smith. Although it may be argued that some of the elements of this package are beyond the scope of the referral, the package attempts to keep within the parameters of the referral and addresses each of the issues presented in the Options Memo circulated by Staff on April 13, 2005. As such it attempts to integrate the various elements of the options memo into a holistic proposal.

I. BLOCK GRANTS/ STATE ALLOCATION MECHANISM

Although the issue of block grants is the last of the issues outlined in the Options Memo, it is critical to the resolution of other issues presented in the Options Memo. Block grants have been advanced as a possible alternative to the current distribution methodology for the High Cost Fund, as long ago as April, 2000 (See "Cooperative Federalism: The State Perspective", Inaugural Telecommunications Policy and Law Syposium, Michigan State University Detroit College of Law). Although "block grants" is the term used in the Options memo, the NARUC Intercarrier Compensation Proposal (NICP) contains a similar concept, the State Allocation Mechanism, which more closely comports with Section 254 of the Federal Telecommunications Act (FTA) than a true block grant. That concept is adopted in the Holistically Integrated Package (HIP).

The State Allocation Mechanism (SAM) would be administered pursuant to FCC guidelines and with continuing FCC oversight and would therefore not be an impermissible delegation of authority. Moreover, it embodies the spirit of cooperative federalism that is the hallmark of Section 254, as recently reaffirmed by the 10th Circuit in Qwest II, 258 F. 3rd at 1203. Under the HIP proposal, the FCC's guidelines would address both how to determine what each state receives for the SAM, and, in general, how each state would allocate its disbursements within the state. Unlike certain packages however, the HIP would leave the states with more discretion to distribute the funds in accordance with the guidelines. For example, State A could distribute SAM funds to ETCs, in accordance with FCC guidelines, but may determine that more than one carrier could be funded in a given rural area, while State B could determine that only one carrier could be funded in a similar rural area. Additionally, if a state wanted to extend the transition period for certain small carriers (e.g., less than 5,000 access lines), it could do so. This discretion is consistent with Section 102(2) of the FTA, with regard to ETC designation and rural exemptions. The FCC guidelines would spell out the factors a state could consider in making its distributions (embedded costs, forward looking costs, Lifeline/Linkup participation) but each state would determine the amount each carrier receives, provided that the permanent rate benchmark proposed in the NICP (125% of the national urban rate) is honored.

Like certain other packages, the HIP proposes that the SAM would take effect after a three year transition period. During the transition period, rural carriers would be held harmless and receive at least as much high cost support as they did during 2004 provided that states certify that the fund is being used for the purposes intended. The states would have authority, during the transition period, to find that a given carrier should receive less high cost support than what historical levels provided, if the carrier's earnings levels were unreasonably high or if service quality deteriorated below acceptable levels. In addition, the states, with the Commission's review, could adopt a "best practices" benchmark, as proposed by Dr.Selwyn, to further control the size of the fund. The HIP proposal is more consistent with the NICP than is the USERP, which provides for a decrease in hold harmless funding in years two and three of $1 per switched line. Although this provision of the USERP is designed to avoid rate shock, other means to achieve this objective (capping SLC increases, etc.) could be used.

States are in a better position to ensure that USF funds are distributed to where they are needed because they are close to the customers and can provide the day-to-day oversight that is necessary to monitor potential abuse. Moreover, it is vitally important to provide a predictable support mechanism for carriers. Higher cost and potentially risky infrastructure investment will not take place at appropriate levels if carriers cannot predict with a level of certainty just which investments will be supported through USF money. Rural companies are especially vulnerable, facing risks unlike their urban counterparts. Rural carriers face unique construction/networking challenges with a lower subscription population and a lower price change tolerance, leaving them less margin for financial error. States need the flexibility to address the unique circumstances of rural carriers.

II. DEFINITION OF RURAL CARRIER

The HIP adopts the principle advanced by the NICP that support for high cost rural areas should not be based on whether that area is served by a “rural” or “non-rural” carrier. Accordingly, the issue of how to define a rural carrier, after the transition period, becomes moot because all carriers serving rural areas would be eligible for support. During the transition period, support would be provided in accordance with the hold harmless provisions detailed above (Section I). For those states that opt-out of the SAM, there would be continued reliance on the existing definition of rural carrier.

III. COST BASIS OF SUPPORT AND CALUCLATION OF SUPPORT

The FCC referral includes a request to consider whether having support for rural carriers based on statewide average costs is more consistent with Section 254 of the Federal Telecommunications Act than the current study area approach. (Par. 44) In the options memo prepared by Staff, the issue of the use of statewide average costs for rural carriers for determining support is presented (Section III, Issue 2, Option 2). Since the HIP adopts the principles that states should be given discretion to allocate USF funds and support should be based on the characteristic of the study area and not the carrier, the combination of study areas is a logical extension of these principles. The USERP makes a compelling case for calculating the high cost support amounts based upon the aggregated characteristics of all carriers in a state as well as combining all existing high cost support (loop, switching, safety net, etc.) into one program. Although it has been argued that combining study areas will make support “less explicit”, the advocates of that position seem to assume that the Commission will continue to use the existing distribution formula for the HCF. However, the adoption of the SAM, with the limitations provided for in the HIP, will allow states to ensure that support is provided where it is needed. Eventually, the use of statewide average costs can provide an incentive for investment in rural facilities. During the transition, reliance on study areas for calculation of support can continue , enabling rural carriers to provide the level of service they have provided in the past.

Combining study areas and existing programs in a holistic manner allows each state to better control the growth in the total USF. The package proposed by Billy Jack Gregg assumes that adopting a unified approach in this way may be outside the scope of the referral, but it is a concept that is incorporated in Stage Two of his plan. The referral, by asking broadly about the use of statewide average costs (Para. 44) and the need to merge various components of the high cost fund (Par. 47), specifically permits the adoption of the USERP proposals. If issues of statewide averaging and merging of component parts of the high cost fund are not considered in this referral, they may not be revisited by the Joint Board for many years.

IV. SUPPORT FOR TRANSFERRED EXCHANGES

The referral specifically asks whether Section 54.305 of the Commission’s rules should be retained, modified or repealed. In keeping with the holistic and integrated nature of the HIP, Section 54.305, which provides limits on high cost funding available to an acquiring carrier based on the historical level of support provided prior to the acquisition. Since the HIP proposes that the distinction between rural and non-rural carriers be eliminated (See II, above), compliance with Section 54.305 would not be necessary. Accordingly, it should be repealed. If acquisitions occur during the transition period, the provision of safety valve support should be continued through the duration of the period.

V. CONTRIBUTION METHODOLOGY

Although the referral does not specifically address the contribution methodology for the USF, the NICP does. It provides for expansion of contributions through the use of a connections, bandwidth or numbers based approach (Section II. #3). The HIP includes such a recommendation. It is imperative that, regardless of the scope of the referral, that all carriers that utilize the public switched telephone network be required to contribute to the USF as soon as possible. The dramatic decrease in traditional long distance wireline traffic and the increase in the use of VoIP and the deployment of IP networks has changed the dynamics of USF so irrevocably that immediate attention to the issue is required . Consideration of the expansion of contributions is necessary to continue to provide the support contemplated in the rest of the HIP

SUMMARY

The Commission’s referral seeks comment on whether to reform the rural HCF support mechanism. The mechanism cannot be viewed in a vacuum. The time has come to consider the integration of the rural HCF, the non-rural fund, the impact of intercarrier compensation and contribution methodology holistically. By recommending a package like HIP, including a SAM, the Joint Board can allow states, pursuant to FCC guidelines, to control the USF while continuing to provide support to areas where it is most needed.